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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1951

No. 715

CALIFORNIA PAVING CO., a partnership composed of Angelo Bragato and Wm. D. Smith and BLOMQUIST OIL SERVICE, INC., a corporation,
Petitioners,

vs.

L. C. SMITH and HILLTOP QUARRY, INC., a corporation,
Respondents.

PETITION FOR WRIT OF CERTIORARI

to the United States Court of Appeals for the Ninth Circuit

and

BRIEF IN SUPPORT THEREOF.

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PHELAN-WALSH PRINTING CO., SAN FRANCISCO

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Petitioners,

vs.

L. C. SMITH and HILLTOP QUARRY, INC., a corporation,

Respondents.

PETITION FOR WRIT OF CERTIORARI to the United States Court of Appeals for the Ninth Circuit.

To the Honorable Fred M. Vinson, Chief Justice of the United States, and to the Honorable Associate Justices of the Supreme Court of the United States:

The petition of CALIFORNIA PAVING CO., a partnership composed of Angelo Bragato and Wm. D. Smith, and BLOMQUIST OIL SERVICE, INC., a

corporation, respectfully shows to this Honorable Court:

INTRODUCTION.

This was an appeal from an order of the United States District Court for the Northern District of California (Tr. 90-95) reversing an order of a referee in bankruptcy requiring respondents to surrender to California Paving Co., debtor in arrangement proceedings, certain quarry leasehold interests and to render to said debtor an accounting thereon. (Tr. 35-48.) The action arose upon the filing of a petition by petitioners (the debtor and one of its creditors) for an order requiring the surrender of possession of said quarry premises and of a leasehold thereon and for the accounting of rents, issues and profits thereof. (Tr. 18-24.) After due proceedings had upon said appeal, the Court of Appeals for the Ninth Circuit, on January 21, 1952, entered its judgment affirming the order of the District Court (193 Fed. (2d) 647) and therein adopted the opinion of the district judge, reported in 95 Fed. Supp. 909. (Tr. 91-95.)

JURISDICTION.

The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254(1) and 11 U.S.C., Section 47(c), Bankruptcy Act, Section 24c.

QUESTION PRESENTED.

The sole question involved in this appeal was and is whether or not the Bankruptcy Court has summary jurisdiction to try an adverse claim of title to a quarry lease which was negotiated for and obtained by a debtor in the ordinary course and conduct of its business, after the filing and confirmation of its petition for an arrangement under Chapter XI of the Bankruptcy Act, where the business profits to be derived from said business by the debtor were expressly included as the basis for the payment of its creditors under the extension plan and where, in the plan of arrangement, the Court expressly "retained jurisdiction of the debtor and its estate and effects until such plan (was) fully consummated"; and where such lease was so acquired by the debtor with its money, and the leasehold was developed with the use of assets which the debtor had in its possession at the time of the commencement of the arrangement proceeding; and where no adjudication in bankruptcy was ever entered as against the debtor.

STATUTES INVOLVED.

The provisions of Chapter XI, Bankruptcy Act, 11 U.S.C., Sections 701-799, must all be considered, but in particular it is the effect of the reservation of jurisdiction, as authorized by Section 357(7), Bankruptcy Act, 11 U.S.C., Section 757(7), upon property acquired by a debtor after confirmation of an arrangement plan which was the basis of the District Court's

order, affirmed by the Court of Appeals, which is to be construed. The interpretation of Sections 341 and 342, Bankruptcy Act, (11 U.S.C., Sections 741 and 742) is also clearly involved.

FACTS.

On May 8, 1947, petitioner California Paving Co. filed in the District Court its petition for an arrangement under Chapter XI of the Bankruptcy Act (11 U.S.C., Section 202). (Tr. 3-12.) After due proceedings had before the referee in bankruptcy thereunder, the arrangement proposed by the debtor (Tr. 10-12) was duly confirmed by order dated July 18, 1947. (Tr. 14-16.) On October 20, 1948, petitioners filed with the referee in bankruptcy their petition for an order requiring respondents to surrender possession of certain quarry premises and of the leasehold thereon and for an accounting of the rents, issues and profits thereof. (Tr. 18-24.) To this petition respondents, on January 4, 1949, filed their answer. (Tr. 25-30.) After trial of the issues and arguments of counsel for the respective parties, on June 9, 1950, the referee in bankruptcy made his order granting the petition. (Tr. 35-48.) Upon petition for review, timely filed with said referee by respondents, and on February 13, 1951, the District Court filed its memorandum opinion and order reversing the referee's order of June 9, 1950, which latter order was, on January 21, 1952, affirmed by the Court of Appeals for the Ninth Circuit.

At the time of the filing of the petition for an arrangement under Chapter XI of the Bankruptcy Act, the debtor was engaged in business as a general paving contractor and was operating local quarries. (Tr. 6.) The arrangement which was subsequently confirmed obviously anticipated, among other things, the continued operation of debtor's business (Tr. 10-12) with an extension of the maturity and enforceability *(not a composition)* of all of debtor's unsecured obligations, except such as had priority under the Bankruptcy Act. On August 28, 1947, in conjunction with its business operations under the plan of arrangement and pursuant to its general scheme of doing business, debtor negotiated a lease upon a quarry known as the "Torpey Ranch" in San Mateo County, California. This lease (Tr. 120-126) was taken in the name of respondent L. C. Smith, a paving contractor and brother of Wm. D. Smith, one of the partners of debtor. (Tr. 109.)

The lease on the Torpey quarry, also called "Top of the Hill" quarry, was taken in the name of respondent L. C. Smith because the lessors would not accept the debtor as lessee by reason of the arrangement proceedings. (Tr. 111.) The referee in bankruptcy found, after a trial on conflicting evidence, that L. C. Smith held the Torpey lease as an involuntary trustee for the debtor. (Tr. 67-80.) The district judge accepted the referee's findings on the merits (Tr. 92) and reversed the referee's order *on the question of summary jurisdiction only.*

REASONS RELIED UPON FOR THE ALLOWANCE OF THIS WRIT.

(1) That the Court of Appeals has decided an important question of federal law which has not heretofore been, but should be, settled by this Court.

(2) That the matter here involved is one of vital importance to the administration of the estates of debtors in proceedings under Chapter XI, Bankruptcy Act, throughout the United States, and one which it is in the public interest to have decided by this Court of last resort.

(3) That the effect of the decision of said Court of Appeals is widespread and will impede rather than facilitate the administration of debtors' estates under Chapter XI, in extension proceedings.

(4) That this is a case of first impression and the decision of the Court of Appeals, unless reversed, will make unworkable and impractical the beneficial results which Congress, in adopting Chapter XI of the Bankruptcy Act, made available to financially distressed debtors.

Wherefore, petitioners pray that a writ of certiorari issue out of this honorable Court, to review the judgment of the United States Court of Appeals for the Ninth Circuit entered in the above matter on January 21, 1952, under its docket number 12,905, and that your petitioners may thereafter have such other and

further relief in the premises as to this honorable Court may seem meet and just.

Dated, San Francisco, California,
April 15, 1952.

Respectfully submitted,

CALIFORNIA PAVING CO., a partnership composed of Angelo Bragato and Wm. D. Smith, and

BLOMQUIST OIL SERVICE, INC., a corporation,

Petitioners,

By ARTHUR P. SHAPRO,
One of Their Attorneys.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

I.

THE BANKRUPTCY COURT HAD SUMMARY JURISDICTION OVER CONTROVERSY BECAUSE (1) PROPERTY WAS ACQUIRED AND DEVELOPED BY DEBTOR WITH ASSETS IN ITS POSSESSION AT THE TIME OF THE FILING OF PETITION FOR ARRANGEMENT AND WAS ACQUIRED IN THE CONDUCT OF DEBTOR'S BUSINESS UNDER THE PLAN.

The opinion of the District Court in this case may be found in 95 Fed. Supp. 909 and at pages 90-95 of the Transcript of Record herein.

The opinion of the Court of Appeals for the Ninth Circuit may be found in 193 Fed. (2d) 647 and at page 202 of the Transcript of Record herein.

From the time the petition was filed, the Bankruptcy Court had control of all property in which the bankrupt has or may claim an interest.

> *Schultz v. England* (C.C.A. 9), 106 Fed. (2d) 764, 767.

The jurisdiction of the Court is not limited to the administration of property which belongs without question to the bankrupt; it extends to the determination of title.

> *Ex parte Baldwin,* 291 U.S. 610, 616, 54 S.Ct. 551, 78 L.Ed. 1020.

The law is well settled that where the property is in the actual or constructive possession of the bank-

rupt when the petition is filed, the Bankruptcy Court has exclusive jurisdiction.

Thompson v. Magnolia Petroleum Co., 309 U.S. 478.

This is also true of property in possession of a debtor in proceedings for an arrangement.

Bankruptcy Act, Section 311, Title 11 U.S.C., Section 711;

Lockhart v. Garden City Bank & Trust Co., (C.C.A. 2d), 116 Fed. (2d) 658.

Petitioners submit that an analysis of the case at bar will establish that the Torpey lease was part and parcel of the business of the debtor which was in existence at the time the petition was filed and hence subject to the summary jurisdiction of the Bankruptcy Court.

A debtor in possession has the title and powers of a trustee in bankruptcy.

> "Where no receiver or trustee is appointed, the debtor shall continue in possession of his property and shall have all the title and exercise all the powers of a trustee appointed under this Act, subject, however, at all times to the control of the court and to such limitations, restrictions, terms, and conditions as the court may from time to time prescribe."
>
> *Bankruptcy Act, Section 342*, Title 11 U.S.C., Section 742.

Thus when a debtor is permitted to remain in possession of a business, funds and property that may

be received by the debtor after the filing of the petition is "after-acquired property" *but not after-acquired property of the debtor,* as such. See *Weiss v. Fleetwood Bank,* 261 App. Div. (N.Y.) 572, 48 Am. B. R. (N.S.) 494. Commencing on page 497 of the bankruptcy report cited above, the Court states:

> "True it is that the funds are after-acquired property, but they are not after-acquired property of the debtor, as such.
>
> Under the act, the debtor is permitted to remain in possession and to conduct the business, but the title of the debtor is the title of a trustee. (Sec. 342.) Thus, while the title of the one who becomes trustee after the failure of the 'arrangement' and adjudication in bankruptcy vests as of the date of the filing of the petition, it is expressly provided that, during the pendency of the 'arrangement' proceeding, the debtor holds title as trustee; and from the time of the filing of an 'arrangement' petition, the property becomes a trust fund under the control of the court until the 'arrangement' is consummated, or for creditors in bankruptcy if the 'arrangement' fails and there is adjudication in bankruptcy, or for the debtor if the 'arrangement' proceeding be dismissed for failure. So here, the business and its assets, after the filing of the petition for an 'arrangement', were not the property of the debtor, but were a trust fund under the control of the court. Increments, gains and credits out of its use were trust funds, as was the property itself, all to be disposed of pursuant to the provisions of the act. *They are not after-acquired property of the debtor,* such as new capital, or goods brought through outside sources, or by

new credits. If a debtor at the time of the filing of a petition were the owner of an interest-bearing bond, or an apartment house, or growing crops, it could hardly be claimed that the trustee would not be entitled to the interest, the net rents, or the harvest, subject to state exemptions, as the case may be. Remington on Bankruptcy (4th Ed.) Sections 1397, 1401; Matter of Scranton Knitting Mills, Inc. (D.C., Pa.), 37 Am. B. R. (N.S.) 532, 23 F. Supp. 803; 2 Collier on Bankruptcy (13th Ed.), p. 1679. It is clear that the defendant was knowingly dealing with property, the title to which was held in trust under the control of the court.

No other question is raised."

A debtor in possession has no right to use funds and property, possession of which he maintains for the benefit of and as trustee for his creditors, to build up a separate and new business for himself. The debtor in possession must account for all receipts, including those acquired from new business. He has no right to divert any of the property which he is administering for the benefit of creditors to his own use and he must account to the Court for new income from such use.

In re Austin, 55 F. Supp. 462.

Money or other property which is the proceeds of property owned by the bankrupt at the time the petition was filed is not after-acquired property and vests in the trustee.

In re Scranton Knitting Mills, Inc., 37 Am. B. R. (N.S.) 532 at 535, 23 F. Supp. 803.

It is submitted that in the case at bar the Torpey lease was acquired by the debtor in the regular course and conduct of its business, which was being operated pursuant to the plan of arrangement. The lease was acquired as a part of its general business operations by use of its property and facilities. *While the lease itself, like the funds in the Weiss case (supra) was after-acquired, it was NOT after-acquired property of the debtor, as such, but as trustee under the plan of arrangement.* Therefore, it was at all times involved herein a part of the business and assets in possession of the debtor and subject to the jurisdiction of the Bankruptcy Court.

It should here be noted that by the express language of the plan of arrangement (Par. 1, Tr. 10), the Court *"retained jurisdiction of debtor and of its estate and effects until * * * such plan (was) fully consummated."* This reservation is expressly authorized by Section 357(7), Bankruptcy Act.

> "An arrangement within the meaning of this chapter may include—
>
> (7) provisions for retention of jurisdiction by the court until provisions of the arrangement, after its confirmation, have been performed;"
>
> Title 11, U.S.C. 757(7).

II.

(2) BECAUSE EVEN IF PROPERTY CAME INTO POSSESSION OF DEBTOR AFTER PETITION FOR ARRANGEMENT WAS FILED, DEBTOR HAD POWERS OF A TRUSTEE THEREOVER, SUBJECT TO CONTROL OF BANKRUPTCY COURT.

Under the provisions of Section 342, Bankruptcy Act (supra), debtor had all title and all powers of a trustee in bankruptcy. The quarry lease negotiated and obtained on August 28, 1947 by the debtor was, in effect, an agreement between the lessors and a trustee in bankruptcy, and thereby the Bankruptcy Court acquired jurisdiction of all questions of title thereto.

> "Possession of property lawfully obtained by officers of the bankruptcy court draws to that court jurisdiction of all questions of title thereto or liens thereon."
>
> *Hollingsworth and Whitney Co. v. Boston,* 39 Am. B. R., 678 at 685.

A debtor in possession in bankruptcy is an officer of the Court.

In re Austin (supra).

Thus, the fact that the property may have come into the actual possession of the debtor after the petition had been filed does not prevent the Court from exercising summary jurisdiction over such property.

The leasehold actually came into possession of the debtor after the execution of the lease when debtor commenced to work the same with its equipment and employees during its operation under the plan.

III.

THE BANKRUPTCY COURT HAD SUMMARY JURISDICTION OVER THE CONTROVERSY EVEN THOUGH THE TORPEY LEASE WAS ACQUIRED AFTER THE FILING OF THE PETITION FOR AN ARRANGEMENT.

Petitioners submit that they have proven satisfactorily that the Torpey lease was not "after-acquired property" of the debtor as such. However, where a petition for an arrangement under Chapter XI of the Bankruptcy Act requesting an *extension,* has been filed, it should make no difference if the property was acquired between the time of the filing of the petition and the consummation of the plan of arrangement or subsequent adjudication in the event the plan fails. It must be borne in mind that there is a difference between a plan that anticipates a composition with creditors and a plan which requests an extension. A composition in bankruptcy is a plan of arrangement between a debtor and his creditors, whereby the amount he can be expected to pay is reduced and liquidated and he is allowed to retain his assets upon condition of his making the payments agreed upon.

In the case of a plan where an extension is proposed, the debtor says to his creditors in effect: "Let me continue to run my business free from molestation by you for a definite period. Let me continue to hold, use, operate and develop my assets, and then at the end of or during that period I shall pay you in full and continue to own and possess the business itself or any assets not used for the payment of your obligations". On the face of this difference, it seems illog-

ical that a debtor who remains in possession as a trustee for creditors (Bankruptcy Act, Sec. 342, Title 11, U.S. Code 742) (quoted above) could remain in possession of assets for the benefit of his creditors and for their benefit maintain, manage and operate his business and then when new business was obtained divide his time in the management of new business for his own benefit prior to the consummation of the plan of arrangement. It is even more illogical and rather shocking to permit him to use funds, equipment, employees and contacts of the business which he is operating for the benefit of his creditors under the plan for the purpose of developing a new asset for his own use.

The District Court and the Respondents have been relying on Section 341, *Bankruptcy Act,* which provides as follows:

> *"Where not inconsistent with the provisions of this chapter,* the powers and duties of the officers of the court and, subject to the approval of the court, their fees, and the rights, privileges, and duties of the debtor shall be the same, where a petition is filed under section 321 of this Act and a decree of adjudication has not been entered in the pending bankruptcy proceeding, as if a decree of adjudication had been entered in such bankruptcy proceeding at the time the petition under this chapter was filed, or, where a petition is filed *under section 322 of this Act, as if a voluntary petition for adjudication in bankruptcy had been filed and a decree of adjudication had been entered at the time the petition under this chapter was filed."* (Italics ours.)
>
> Title 11, U.S.C. 741.

This section in effect implies that the ordinary bankruptcy procedure would be followed *unless inconsistent* with the provisions of Title 11 of the United States Code, Chapter 11, Sections 701-799 relating to arrangements. It is Petitioners' position that, to apply the rule in bankruptcy proceedings that property acquired by the bankrupt after the filing of his petition becomes the property of the bankrupt, free from administration, is inconsistent with the basic nature of a plan of arrangement based upon an extension. There do not seem to be many authorities interpreting the issue before the Court under the provisions of Chapter XI. There are some cases which by way of dicta indicate that the Bankruptcy Court does not acquire jurisdiction over after-acquired property. These cases, however, base their statements on an interpretation of Section 341 of the Bankruptcy Act in which it implies that ordinary bankruptcy procedure will be followed.

This interpretation does not seem sound to Petitioners because it overlooks a basic difference and inconsistency between a bankrupt and a debtor in possession under an extension arrangement. A bankrupt surrenders his assets and has nothing further to do with them. A trustee is appointed who takes possession of everything for the benefit of creditors. In the case of an arrangement plan *where an extension is requested,* the debtor remains in possession and continues to operate his business and manage his assets as trustee for the benefit of his creditors and as an officer of the Court.

In re Austin (supra).

It is not logical to permit him to use the business and its assets which he operates pursuant to the plan for the purpose of acquiring new assets for himself. It is inconsistent with the duties of any trustee to permit him to use trust assets for his own benefit.

The case of *In re Austin* referred to above was one in which an attorney filed a petition for an arrangement under Chapter XI of the Bankruptcy Act. He refused to account for new fees that came into his hands after the filing of the petition. The Court decided that he must account for them.

> "(1) It is thus apparent that a debtor in possession is as much an officer of the court as a receiver or trustee would be. As such, he is charged with the duty of administering the estate of the debtor, during the pendency of attempts to effect an arrangement, primarily for the benefit of creditors, 'subject, however, at all times to the control of the court and to such limitations, restrictions, terms, and conditions as the court may from time to time prescribe.' Section 342 of Bankruptcy Act, supra. He must account to the court for all income derived from the operation of the business and is not entitled to divert any of such income to his own use without specific court approval. Harry S. Austin was permitted by court order, on his own application, to use $1000 out of fees then due and payable or any fees coming into his hands after the filing of the petition, for living and office expenses. It is implicit that any fees or other income beyond that amount were to be held by him subject to further direction of the court."
>
> *In re Austin,* 55 F. Supp. 462, 463.

The *Austin* case would seem to show that the Court does acquire jurisdiction over after-acquired property and like the *Weiss* case and the *Scranton Knitting Mills* case (supra) clearly and conclusively holds that if the after-acquired property is an accretion of assets or derived in the course of the debtor's business the Court has summary jurisdiction thereover.

Petitioners submit that any other view would lead to an absurd result entirely inconsistent with the purpose of a Chapter XI proceeding. A debtor with the use of the creditors' assets could develop a new business, neglect the old one that he is operating for their benefit, permit an adjudication to be entered against him, turn over to the trustee the old assets and end up with a new business free and clear of his old obligations. This is not the purpose of Chapter XI, and it is only reasonable to require a debtor to account for property acquired after the filing of the petition when his possession is as a trustee and officer of the Court.

IV.

THE PROVISIONS OF THE BANKRUPTCY ACT CONTEMPLATE JURISDICTION OVER DEBTOR AND ALL OF HIS PROPERTY UNTIL CONSUMMATION OF PLAN.

Section 341 of the Bankruptcy Act, supra, provides in substance that where not inconsistent with the provisions of this chapter the general provisions as to bankruptcy procedure shall be applicable. Section

70h of the Bankruptcy Act not only is consistent with but also specifically applies, to the provisions of Chapter XI.

> "Whenever an arrangement or wage-earner plan shall be set aside or discharge revoked, the trustee shall, upon his appointment or qualification, be vested as herein provided with the title to all of the property of the bankrupt *as of the date of the final decree setting aside the arrangement* or wage-earner plan or revoking the discharge." (Italics ours.)

Under the provisions of Section 70h it is clearly contemplated that the Bankruptcy Court is to retain complete jurisdiction over the bankrupt and all of his property until the plan of arrangement is consummated. In accordance with the provisions of this section, a trustee when appointed would take title to all assets of the *debtor as of the date of the final decree setting aside the arrangement* and not as of the date of the filing of the petition as in the case of an ordinary bankruptcy. Thus the trustee would take title to after-acquired property without question. Clearly then the act itself contemplates a different treatment of after-acquired property in the case of an arrangement rather than a straight bankruptcy proceeding. It must have been intended that the after-acquired property of a debtor in possession be considered in possession of the Court or how could the Court presume to act upon it as provided by Section 70h? Clearly if such property was to be held in the posses-

sion of a debtor, entirely free from the jurisdiction of the Court, then 70h would be wholly ineffectual.

To accept the interpretation of the District Court and that of the Respondents, the debtor in possession could refuse (under Section 341, Bankruptcy Act) to turn over to the trustee, when appointed, all property acquired after the filing of the petition, thus completely nullifying Section 70h.

Petitioners submit that Section 70h clearly indicates that the provisions of the Bankruptcy Act itself contemplate that the Bankruptcy Court shall have complete jurisdiction over the debtor and all of his property after the filing of the petition for arrangement until the final consummation of the plan.

CONCLUSION.

Petitioners feel that the error into which the district judge fell, and in which error the Court of Appeals followed, consisted largely in the unwarranted application, to an extension arrangement under Chapter XI of the Bankruptcy Act, of the same rigid rules on summary jurisdiction applied to ordinary bankruptcy proceedings as in *Cline v. Kaplan,* 323 U.S. 97, 65 S.Ct. 155, 89 L.Ed. 97. This, we submit, was not contemplated by Congress in its enactment of Chapter XI, Bankruptcy Act.

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Dated, San Francisco, California,
April 15, 1952.

Respectfully submitted,
SHAPRO & ROTHSCHILD,
ARTHUR P. SHAPRO,
AUGUST B. ROTHSCHILD,
Attorneys for Petitioners.

SUPPLEMENTAL ARGUMENT IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

The undersigned are the respective counsel for the Board of Trade of San Francisco and the Los Angeles Credit Managers' Association. The membership of both organizations consists of a very large number of wholesalers, manufacturers and jobbers located in the metropolitan areas of San Francisco and Los Angeles, California. Both organizations were formed for the purpose of enabling its members, who may be creditors of an embarrassed or insolvent debtor and all other creditors of such a debtor, to act jointly in their dealings with him. Frequently these creditors have claims against individuals, copartnerships and corporations engaged in various types of business which due to financial difficulties must seek an extension of time to discharge their indebtedness.

Advantage may be taken by such debtors of the provisions of Chapter XI of the Bankruptcy Act. As counsel for the two above mentioned organizations, we have always advised its members who are creditors of a debtor filing a Chapter XI proceeding that all assets, subsequently acquired by the debtor under an extension plan during the pendency of the Chapter XI proceeding, were subject to the summary jurisdiction of the Bankruptcy Court and subject to being liquidated for payment of Chapter XI administration expenses and prior creditors' claims if the debtor was thereafter adjudicated a bankrupt.

We therefore subscribe to the preceding argument of counsel for petitioners in support of the granting

of a writ of certiorari. The decision of the Court of Appeals for the Ninth Circuit affirming the District Court denies the existence of such summary jurisdiction of the Bankruptcy Court, and permits a debtor following his adjudication as a bankrupt to withhold making delivery to his trustee in bankruptcy of all property acquired as a debtor in possession after the filing of his Chapter XI petition free from the claims of his new and old creditors including assets acquired in the course and conduct of the very business which was the basis of the extension plan. The preceding argument and cases cited, the analyses and comments upon Section 70h of the Bankruptcy Act, and the several sections of Chapter XI thoroughly demonstrate the error in the ruling of each of the above Courts that the Bankruptcy Court has no summary jurisdiction over the assets acquired by a debtor in possession.

We respectfully submit that the best interests of all creditors of a debtor in possession in any pending or future Chapter XI proceeding warrants the issuance of a writ of certiorari.

Respectfully submitted,

JAMES M. CONNERS,
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Attorneys for Los Angeles Credit Managers' Association.

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L. C. SMITH and HILLTOP QUARRY, INC.,
Respondents.

BRIEF FOR RESPONDENTS.

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WALSH PRINTING CO., SAN FRANCISCO, CALIFORNIA

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In the Supreme Court
OF THE
United States

OCTOBER TERM, 1951

No.

CALIFORNIA PAVING CO., a Partnership Composed of Angelo Bragato and Wm. D. Smith and BLOMQUIST OIL SERVICE, INC., a Corporation,
Petitioners,

vs.

L. C. SMITH and HILLTOP QUARRY, INC.,
Respondents.

BRIEF FOR RESPONDENTS.

The record does not bear out the petitioners' statement of facts relied on for reason that a writ should issue in this case involving the determination of a substantial and adverse claim to title to a leasehold estate on summary proceedings before a referee in bankruptcy.

INACCURACIES OF THE STATEMENT UPON WHICH THE PETITION IS BASED.

Petitioners, at page 3 of their petition, state that *"the quarry lease was acquired by the debtor with its money."* The record shows (R. 151, 153-154), and petitioners at page 5 of their petition concede, that the lessors (the Torpeys) of the quarry premises flatly refused to give the quarry lease to the debtor because of the existence of the arrangement proceeding. This was admitted by William Smith, partner of debtor, who had been negotiating with lessors. (R. 111, 129, 139.) It is uncontradicted in the record that no consideration whatever passed from the debtor or the partners composing the same to the lessors at the time the ten-year leasehold interest in the quarry was granted. The consideration for the lease was, and of necessity had to be, the undertaking of respondent L. C. Smith to pay rents and royalties as set forth in said lease (R. 120-126), which he alone signed and to whom the lessors can alone look under the lease for the rents and royalties.

REASONS WHY CERTIORARI SHOULD NOT BE GRANTED.

1. The petition is premised upon an erroneous statement of fact without support in the evidence, the findings of the referee, or the opinion of the District Court. Other inaccuracies are pointed out in the body of this brief.

2. It is settled by innumerable decisions of this Honorable Court that a bankruptcy court has no summary jurisdiction to determine title to property which was not in the actual or constructive possession of the bankrupt at the time the petition in bankruptcy was filed. The decision of the District Court merely applied that concept to the facts in the case at hand under and by virtue of the statutory mandate governing the jurisdiction, power and duties of the Bankruptcy Court in arrangement proceedings. § 312 of the Bankruptcy Act, Title 11 U.S.C., § 712(2).

3. The debtor and its creditor, petitioners here, are attempting to invoke the summary jurisdiction of the Bankruptcy Court to reach property which was never a part of the estate of bankruptcy or the subject of the debtor's trust.

QUESTION INVOLVED.

The sole question for determination is whether a referee has summary jurisdiction in an arrangement proceeding instituted under § 322 of the Bankruptcy Act, 11 U.S.C.A. § 722 (see Appendix "A" of this brief), to determine title to a leasehold estate which first came into existence more than three and one-half months after the petition for an arrangement was filed and more than a month after the order confirming said arrangement was entered and where the sole consideration for said lease was the undertaking of respondent L. C. Smith contained in said lease to pay rents and royalties. The jurisdictional question was

saved in the answer filed in the proceeding by respondents. (R. 28.)

ARGUMENT.

I.

THE TORPEY LEASE WAS NOT IN EXISTENCE AT THE TIME THE DEBTOR'S PETITION FOR AN ARRANGEMENT WAS FILED AND THE BANKRUPTCY COURT HAD NO JURISDICTION THEREFORE TO SUMMARILY DETERMINE TITLE THERETO.

It is settled that property coming to the bankrupt after filing of the petition in bankruptcy does not belong to the estate of bankruptcy and is not subject to the summary jurisdiction of the Bankruptcy Court. *Bank of California Nat'l Ass'n v. McBride* (9th Cir., 1943), 132 Fed. (2d) 769. In that case, at page 771, the rule is aptly stated as follows:

> "The court had summary jurisdiction in the premises if, when the bankruptcy petition was filed, the property was actually or constructively in the possession of the bankrupt; or if at that time possession was held by a person who made no adverse claim to the property, or whose adverse claim was determined on inquiry to be merely colorable. Taubel-Scott-Kitzmiller Co. v. Fox, 264 U.S. 426, 44 S. Ct. 396, 68 L. Ed. 770; Harrison v. Chamberlin, 271 U.S. 191, 46 S. Ct. 467, 70 L. Ed. 897; Isaacs v Hobbs Tie & T. Co., 282 U.S. 734, 51 S. Ct. 270, 75 L. Ed. 645."

The foregoing criteria of summary jurisdiction in ordinary bankruptcy proceedings are embraced and

set forth as the standards of jurisdiction of the Court in arrangement proceedings by virtue of the Bankruptcy Act, § 312, Title 11 U.S.C.A. § 712(2), as follows:

> "Where not inconsistent with the provisions of this chapter, the *jurisdiction, powers, and duties of the court* shall be the same——
>
> * * * * * * *
>
> "(2) where a petition is filed under section 722 of this title as if a voluntary petition for adjudication in bankruptcy had been filed and a decree of adjudication had been entered at the time the petition under this chapter was filed." (Emphasis ours.)

In *Collier on Bankruptcy,* 14th Ed., Vol. 8, p. 807, it is said:

> "The jurisdiction of the Bankruptcy Court is exercised partly in summary proceedings and partly in plenary suits. *The same principles which determine, where a trustee is involved, whether the court may proceed summarily or whether a plenary suit is necessary, are determinative where a debtor in possession is involved.* Where those principles establish summary jurisdiction, a debtor in possession may proceed summarily and need not resort to a plenary suit." (Emphasis ours.)

See, also, *Collier on Bankruptcy,* 14th Ed., Vol. 8, p. 124.

It follows in logical order that the reservation of jurisdiction in the plan of arrangement (R. 10) set

forth pursuant to § 357(7) of the Bankruptcy Act, 11 U.S.C. § 757(7), is merely a reservation of that jurisdiction specifically defined and delimited by § 312 of the Bankruptcy Act, Title 11 U.S.C., § 712(2) quoted supra.

If the Torpey lease was acquired after the petition for arrangement was filed and was not a gain or increment of property in the hands of debtor when the petition was filed, the Referee had no jurisdiction to summarily determine title thereto. *Wood v. Scott,* 187 F. (2d) 252; *Weiss v. Fleetwood Bank,* 26 N.Y. Supp. (2d) 583; *In re Retail Stores Delivery Corp.,* 5 Fed. Supp. 892; *In re Scranton Knitting Mills,* 23 Fed. Supp. 803.

That the Torpey lease came into existence more than three months after the petition for arrangement was filed is uncontradicted in the record (R. 120-126) and such was found as a fact by the Referee (R. 67-69, paragraphs three and four). Petitioners at page 13 of their brief impliedly concede this but labor the point that acquisition of the Torpey lease was part of the general scheme of operation of debtor's business pursuant to the plan of arrangement and, in effect, was a gain or proceeds of property possessed by the debtor at the time the petition for arrangement was filed. No such general scheme of acquisition is set forth in the plan of arrangement (R. 6-12), which itself was offered more than three and one-half months before the lease came into existence and which was confirmed (R. 14-16) five weeks before the lease came into existence. In the absence of a provision

in the plan of arrangement committing future property to the debtor's estate, the Bankruptcy Court has no jurisdiction over such property. *Miller v. Woolley* (9th Cir., 1944), 141 Fed. (2d) 837, 838-839. The Referee neither found that the acquisition of the Torpey lease was part of the general scheme of the debtor's business operation nor did he, by that legerdemain or otherwise, find that the Torpey lease was a gain or increment of assets in the hands of debtor at the time the petition for arrangement was filed. (R. 67-80.) Those findings are barren of any facts upon which summary jurisdiction could be based and, in themselves, actually negative the same. (R. 67-69, paragraphs 3, 4, 5.) *Heath v. Helmick* (9th Cir., 1949), 173 Fed. (2d) 157.

The debtor in this case had the burden of proving the facts supporting jurisdiction, in the absence of which the case would be dismissed. *Wuchner v. Goggin* (9th Cir., 1949), 175 Fed. (2d) 261; *Kelso v. Maclaren,* 122 Fed. (2d) 867; *In re Retail Stores Delivery Corp.,* 5 Fed. Supp. 892.

We again direct the attention of the Court to the fact that lessors flatly refused to give the lease to the debtor (R. 151, 153-154) because of the existence of the arrangement proceeding. That fact is conceded in petitioners' brief at page 5. This was admitted by William Smith, partner of debtor, who had been negotiating with lessors. (R. 111, 129, 130.) It is uncontradicted in the record that no consideration whatever passed from the debtor or the partners composing the same to the lessors at the time the ten-year

leasehold interest in the quarry was granted. The consideration for the lease was, and of necessity had to be, the undertakings of respondent L. C. Smith to pay rents and royalties as set forth in said lease (R. 120-126) which he alone signed and to whom the lessors can alone look under the lease for the rents and royalties. The Torpey lease was something new, separate and distinct from any property owned or possessed by debtor at the time the petition for arrangement was filed. It was an asset which came into being after petition filed and as a result of the pledged credit of respondent L. C. Smith. (R. 154.) The lease was, to paraphrase the language of *Weiss v. Fleetwood Bank,* supra: "after-acquired property brought through outside sources and by new credits." If debtor undertook to mine the quarry with the equipment comprising part of the arrangement estate, the Bankruptcy Court can summarily require him to account for the proceeds. *Weiss v. Fleetwood Bank,* supra. Such activity certainly cannot change the character of the leasehold estate which was "after-acquired property".

The case of *In re Austin,* 55 F. Supp. 462, so strongly relied on by petitioners, is misinterpreted by them. The *Austin* case is perfectly consistent with the ruling in *Miller v. Woolley,* supra, which is to the effect that the Bankruptcy Court has no power over future earnings of the debtor unless the plan of arrangement proposed by the debtor offers his salary to be earned in the future as part of the debtor's estate. It is apparent from the decision of

the Court in the *Austin* case that debtor pledged his future earnings as part of the plan of arrangement. The Court said at page 463:

> "Harry S. Austin was permitted by court order *on his own application* to use $1,000 out of fees then due and payable, or any fees coming into his hands after the filing of the petition, for living and office expenses." (Emphasis ours.)

II.

THE SUMMARY JURISDICTION OF THE BANKRUPTCY COURT IS THE SAME IN ARRANGEMENT PROCEEDINGS AS IN ORDINARY BANKRUPTCY.

Parts II and III of the brief of petitioners are devoted to argument that in arrangement proceedings "after-acquired" property of the debtor is subject to the summary jurisdiction of the Bankruptcy Court either (1) because the debtor takes such property as a trustee in bankruptcy, or (2) because of the claimed nature of arrangement proceedings. An analysis of the statutes involved will not support appellants' arguments.

(1) The Bankruptcy Act, § 342, Title 11 U.S.C.A. § 742, provides that a debtor in possession under an arrangement proceeding shall have "all the title and exercise all the powers of a trustee" appointed under the Bankruptcy Act. A trustee's rights relative to the property of a debtor in arrangement proceedings are defined in § 70a of the Bankruptcy Act, 11 U.S.C.A. § 110, which provides:

> "a. The trustee of the estate of a bankrupt, and his successor or successors if any, upon his or their appointment and qualification, shall in turn be vested by operation of law with the title of the bankrupt *as of the date of the filing* of the petition in bankruptcy or *of the original petition proposing an arrangement* or plan under this title * * *" (Emphasis ours.)

It is elementary that the trustee under § 70a, supra, acquires only property and interests belonging to the debtor at the time the petition is filed and "after-acquired property" is no part of the bankrupt estate. *Everett v. Judson,* 228 U.S. 474; *Bank of Nez Perce v. Pindel* (9th Cir., 1912), 193 Fed. 917, 924; *In re Leibowitt,* 93 Fed. (2d) 333. In an arrangement proceeding instituted under § 322 of the Bankruptcy Act, 11 U.S.C.A. § 722, the trustee takes title to the property of the debtor in existence as of the date the petition for arrangement was filed. *Lockhart v. Garden City Bank,* 116 Fed. (2d) 658; *Wood v. Scott,* 180 F. (2d) 252.

The title,* therefore, if any, which petitioner California Paving Company acquired in and to the Torpey lease, which came into existence on August 28, 1948 (more than three and one-half months after the petition for arrangement was filed) was held by

*William D. Smith, partner in debtor and petitioner California Paving Company, admitted both to attorney Francis P. Walsh and to attorney Daniel J. Creeden that California Paving Company had no interest in the quarry property but that the operator of the quarry rented California Paving Company equipment and paid California Paving Company so much a yard for loading the rock. (T.R. pp. 184-186.)

such appellant as a discharged debtor (11 U.S.C.A. § 741; Appendix "A") and not in its capacity as a trustee for debtor. In the case of *Wood v. Scott,* 180 Fed. (2d) 252, the Court reversed an order of the referee requiring an employer of debtor to deliver up wages and bonuses of debtor accrued as of the date the petition in bankruptcy was filed rather than the date the petition for an arrangement was filed. The Appellate Court held that such was unauthorized under 11 U.S.C.A. § 778(2). (Appendix "A".) The same limitation as contained in 11 U.S. C.A. § 778(2), in identical terms, is placed on the power of the Bankruptcy Court at the outset in an arrangement proceeding 11 U.S.C.A. § 712(2), quoted supra, p. 5. It follows in logical order that the decision in *Wood v. Scott,* supra, would have been the same even in the absence of subsequent bankruptcy.

The case of *Hollingsworth & Whitney Co. v. Boston,* 39 Am. B. R. 678, relied on by petitioners, did not involve "after-acquired" property but rather property transferred by the bankrupt within four months of bankruptcy, the proceeds of which were turned over to the trustee in bankruptcy under an agreement which, by the interpretation given to it by the Court, vested the Bankruptcy Court with jurisdiction.

(2) Petitioners assert that the opening clause common to 11 U.S.C.A. § 712, quoted supra, § 741 (Appendix "A"), and § 752 (Appendix "A"), namely, "Where not inconsistent with the provisions of this chapter," in some unexplained manner enlarges the jurisdiction of the Bankruptcy Court so as to em-

power it to deal summarily with "after-acquired property" in arrangement proceedings. Petitioners, however, fail to cite a single statute applicable to arrangement proceedings which enlarges the jurisdiction of the Court over that which it has in ordinary bankruptcy. So far as we have been able to ascertain, there is no such statute.

Courts of bankruptcy and their creature, the referee, are of statutory origin and possess only the jurisdiction and powers expressly or by necessary implication conferred by statute. *Gamble v. Daniel,* 39 Fed. (2d) 447, 452-3; *Chicago Bank of Commerce v. Carter,* 61 Fed. (2d) 986. Failure of such laws to provide authority to act in any particular contingency result, as said in the case of *In re Fox West Coast Theatres,* 25 Fed. Supp. 250, 264 (affirmed 88 Fed. (2d) 212; cert. den. 301 U.S. 710), in a "lacuna of jurisdiction". In the absence of a statute granting power to courts of bankruptcy to determine controversies involving "after-acquired property" of a debtor in arrangement proceedings, there is no "inconsistency" with ordinary bankruptcy proceedings whatever and the usual tests of the Bankruptcy Court's summary jurisdiction are applicable. In *Collier on Bankruptcy,* 14th Ed., page 124, it is said:

> "The provisions of Chapters I to VII which confer summary jurisdiction upon the Bankruptcy Court in cases where it has actual or constructive possession of the property are not inconsistent with the provisions of Chapter XI [arrangement proceedings] and hence are applicable in a proceeding under that chapter."

In the cases of *Lockhart v. Garden City Bank,* supra, and *Wood v. Scott,* supra, both of which involve arrangement proceedings, the Court applied the test of summary jurisdiction applicable in ordinary bankruptcy.

III.

WHERE A DEBTOR IN AN ARRANGEMENT PROCEEDING IS SUBSEQUENTLY ADJUDGED A BANKRUPT, THE TRUSTEE IN BANKRUPTCY TAKES TITLE TO THE PROPERTY OF THE DEBTOR AS OF THE DATE OF THE FILING OF THE ARRANGEMENT PROCEEDINGS.

It has been previously pointed out that under the statutory scheme for arrangement proceedings, the jurisdiction, powers and duties of the Court (11 U.S.C.A. § 712(2)), the powers and duties of the officers of the Court and of the debtor (11 U.S.C.A. § 741), and the rights, duties and liabilities of creditors and of all other persons (11 U.S.C.A. § 752) are the same in arrangement proceedings instituted under § 322 of the Bankruptcy Act (11 U.S.C.A. § 722) as that in ordinary bankruptcy after an adjudication has been entered.

If the debtor in arrangement proceedings instituted under § 322 of the Bankruptcy Act is subsequently thrown into bankruptcy for any reason *save fraud,* § 377 and § 378 of the Bankruptcy Act (11 U.S.C.A. § 777, § 778) are applicable and the trustee in bankruptcy takes *title to the property of the debtor in existence as of the date the petition for arrangement*

was filed. Miller v. Woolley, supra; ***Wood v. Scott,*** supra; *Lockhart v. Garden City Bank,* **supra.**

Section 378 of the Bankruptcy Act (11 U.S.C.A. § 778(2) is as follows:

> "Upon the entry of an order directing that bankruptcy be proceeded with——
>
> * * * * * * *
>
> (2) In the case of a petition filed under section 722 of this title, the proceedings shall be conducted, so far as possible, in the same manner and with like effect *as if a voluntary petition for adjudication in bankruptcy had been filed and a decree of adjudication had been entered on the day when the petition under this chapter was filed;* and the trustee nominated by creditors under this chapter shall be appointed by the court, or, if not so nominated or if the trustee so nominated fails to qualify within five days after notice to him of the entry of such order, a trustee shall be appointed as provided in section 72 of this title." (Emphasis ours.)

Section 70h of the Bankruptcy Act (11 U.S.C.A. § 110(h)), quoted in petitioners' brief, speaks of an arrangement being "set aside". The only statutory authority for "setting aside" an arrangement proceeding is *for fraud* under § 386(1) of the Bankruptcy Act, 11 U.S.C.A. § 786(1), and it is in that instance only that 70h of the Bankruptcy Act, supra, becomes applicable, vesting the trustee with title of the debtor "as of the date of the final decree setting aside the arrangement." *Collier on Bankruptcy,* 14th Ed., Vol. 8, p. 1461 et seq. By their very nature, the

provisions of § 70h, supra, of the Bankruptcy Act are an exception to the general rule enunciated by § 378 of the Bankruptcy Act, 11 U.S.C.A. § 778(2) quoted supra, and 70a of the Bankruptcy Act, 11 U.S.C.A. § 110a, quoted supra, and in effect are a penalty for the fraud of the debtor. There is no suggestion in this case that the debtor has practiced fraud in the procuring of the arrangement, and until the happening of that contingency the section is not applicable at all (*Collier on Bankruptcy,* 14th Ed., Vol. 8, p. 1460) and the Bankruptcy Court has no jurisdiction over "after-acquired property" such as that in question here. *Miller v. Woolley,* supra; *Wood v. Scott,* supra; *Lockhart v. Garden City Bank,* supra.

CONCLUSION.

It is respectfully submitted that the petition for writ of certiorari should be denied.

Dated, San Francisco, California,
May 9, 1952.

M. MITCHELL BOURQUIN,
Attorney for Respondents.

JOHN E. LYNCH,
Of Counsel.

(Appendix A Follows.)

Appendix A

11 U.S.C.A. § 722:

"If no bankruptcy proceeding is pending, a debtor may file an original petition under this chapter with the court which would have jurisdiction of a petition for his adjudication."

11 U.S.C.A. § 741:

"Where not inconsistent with the provisions of this chapter, the powers and duties of the officers of the court and, subject to the approval of the court, their fees, and the rights, privileges, and duties of the debtor shall be the same, where a petition is filed under section 721 of this title and a decree of adjudication has not been entered in the pending bankruptcy proceeding, as if a decree of adjudication had been entered in such bankruptcy proceeding at the time the petition under this chapter was filed, or, where a petition is filed under section 722 of this title, as if a voluntary petition for adjudication in bankruptcy had been filed and a decree of adjudication had been entered at the time the petition under this chapter was filed."

11 U.S.C.A. § 752:

"Where not inconsistent with the provisions of this chapter, the rights, duties, and liabilities of creditors and of all other persons with respect to the property of the debtor shall be the same, where a petition

is filed under section 721 of this title and a decree of adjudication has not been entered in the pending bankruptcy proceeding, as if a decree of adjudication had been entered in such bankruptcy proceeding at the time the petition under this chapter was filed, or, where a petition is filed under section 722 of this title, as if a voluntary petition for adjudication in bankruptcy had been filed and a decree of adjudication had been entered at the time the petition under this chapter was filed."

11 U.S.C.A. § 778(2):

"Upon the entry of an order directing that bankruptcy be proceeded with——

* * * * * * *

(2) in the case of a petition filed under section 722 of this title, the proceeding shall be conducted, so far as possible, in the same manner and with like effect as if a voluntary petition for adjudication in bankruptcy had been filed and a decree of adjudication had been entered on the day when the petition under this chapter was filed; and the trustee nominated by creditors under this chapter shall be appointed by the court, or, if not so nominated or if the trustee so nominated fails to qualify within five days after notice to him of the entry of such order, a trustee shall be appointed as provided in section 72 of this title."